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May 13, 1997

**The Honorable John D. Dingell, Ranking Member
Commerce Committee Democratic Office
564 Ford House Office Building
U. S. House of Representatives
Washington, D. C. 20515**

Dear Representative Dingell:

Thank you for providing PG&E Corporation (PG&E) with the opportunity to address the issues you raised in your letter of April 10, 1997. We appreciate your willingness to consider our views, and the views of other interested parties at the outset of the debate. PG&E firmly believes that the electric industry restructuring law adopted by the California legislature is the right policy for our state and our customers. Accordingly, we are working diligently to ensure its success, as well as the availability of retail choice for our customers beginning on January 1, 1998.

As our response will indicate, we believe competition will benefit customers in the state of California, and a restructured industry will benefit electric power customers throughout the United States. For those reasons, we are hopeful other states will similarly act to provide the benefits of customer choice and competition in this industry. If states fail to act, however, there may be a need for federal legislation to ensure that the benefits of competition in electric power are realized by customers across the country. We hope, though, that federal legislation would recognize and defer to the efforts of those states, like California, that have taken comprehensive steps to offer customer choice.

Background

As you are aware, the electric industry restructuring process began in California in 1992 when the California Public Utilities Commission (CPUC) initiated a comprehensive review of the current and future trends in the industry. In April 1994, the CPUC issued a proposal to change the way it regulates the industry. In December 1995, the CPUC promulgated a decision that encouraged competition among suppliers of electricity, offered retail customer choice and flexibility in the choice of suppliers, and reformed the manner in which investor-owned utilities (IOUs) are regulated. The California Legislature built upon that framework and developed comprehensive restructuring legislation that passed in the summer of 1996. This legislation, Assembly Bill (AB) 1890, was unanimously passed by both chambers and was signed by the governor.

This bold restructuring of the energy industry was only possible because of the unprecedented consensus among almost all key stakeholders in the electric industry in California -- customers (large and small), utilities (including municipals), labor, agriculture, independent power producers, energy marketers and environmental groups. These groups worked with regulators, legislators, and local governments to come together and agree on a consensus approach. PG&E continues to work today to protect and maintain that consensus as the law is being implemented.

In this regard, PG&E is working together with the many other affected parties to implement the California law in numerous forums, including the CPUC, the legislature, the Oversight Board and the Independent System Operator and Power Exchange boards. Many of the issues raised in your letter have been, and will continue to be, addressed through the implementation process here in California. We know that our dedicated move to customer choice is the correct course for California, and we hope that our experience will be of help to the Committee as it considers this important matter.

Retail Choice and Direct Access

The California law requires the three large IOUs in the state (PG&E, Southern California Edison and San Diego Gas and Electric Company) to begin providing our customers with retail choice (direct access) beginning on January 1, 1998. PG&E is committed to meeting that date. Under the law, direct access must be phased in for all customers within four years. However, the CPUC was directed by the legislature to develop a schedule equitable to all customer classes that could be accomplished as soon as is possible, consistent with operational and other technical considerations.

In a decision issued on May 6, 1997, the CPUC determined that no phase-in is required and that direct access will be made available to all customers on January 1, 1998. Large industrial, commercial and agricultural customers with loads greater than 20 kW are required to install meters capable of providing hourly data to enjoy the benefits of direct access. Statistical load profiles may be used by residential and smaller customers to access the new system.

Before the CPUC finally approved a direct access plan, however, the transition to direct access was already underway. PG&E has been planning for and beginning to implement the new processes that will be necessary to provide direct access to our customers.

Stranded Costs and Securitization

California has confirmed that it is appropriate to give IOUs the opportunity to recover costs for generation-related assets and obligations that may not be otherwise recoverable through market prices in a restructured competitive market -- so-called "stranded costs." What the California legislature specifically provided is an opportunity, not a guarantee, to collect stranded costs over a four-year period through imposition of a "competitive transition charge" (CTC). PG&E bears the risk that it can collect all of the utility-owned

generation-related CTCs by the first quarter of 2002; but if the current costs of providing electric service allow, the recovery of the generation stranded costs could end sooner than 2002, thus allowing rates to decline. Collection of CTCs associated with QF power purchase contracts will extend over the life of those contracts.

Under the California utility ratemaking process, CTCs are already incorporated into rates and are being amortized over an extended period. AB 1890 freezes those rates at current levels for four years. CTCs are not additional charges tacked onto customers' bills and will only be recovered to the extent the frozen rates exceed the revenue required to cover the other costs of providing electric services. Therefore, under the CTC recovery plan, PG&E must bear several risks, including higher fuel prices increasing generation costs, inflation increasing all other operating costs, or an economic slowdown reducing revenues -- any one of which or a combination of which, could reduce the amount of CTCs collected.

In restructuring the energy industry, California assumed that large sophisticated customers could reap their own rewards in a competitive market. To benefit residential and small customers, the legislature proposed financing a 10 percent rate reduction for those customers, effective January 1, 1998, through the issuance of rate reduction bonds. The CPUC and the California Infrastructure and Economic Development Bank (IED) are authorized under the legislation to review and approve the utilities' rate reduction bond or securitization proposals. The first step in this process is for each utility to apply to the CPUC for review and approval of its rate reduction bond financing applications. The transition costs outlined in those applications will be financed by rate reduction bonds, the debt service of which will be recovered by a non-bypassable charge called the Fixed Transition Amount. It will be collected only from customers receiving the rate reduction.

Reliability

The California law mandates creation of a statewide Independent System Operator (ISO), to manage the transmission system in California, and an independent Power Exchange (PX), to serve as an electricity commodity exchange for the state. The ISO was established both to address market power concerns and to ensure reliability in the new competitive marketplace. PG&E is providing technical expertise to the ISO operators and is working closely with them to guarantee that the transition to this new system is smooth.

The state's electric power utilities will transfer operational control of their transmission systems to the ISO, which will be regulated by the Federal Energy Regulatory Commission (FERC). The ISO will provide open access to the IOUs' transmission system and ancillary services, and manage transmission and constraints. The ISO will also function as an oversight mechanism, and will conduct an audit following any major electricity outage and, if necessary, impose sanctions on the utilities at fault.

The ISO is to adopt inspection, maintenance, repair and replacement standards for the transmission facilities under its control. The standards, which may be performance-based, prescriptive, or both, are to provide for high quality, safe and reliable service. In addition,

when establishing reliability standards, the ISO will take into consideration variables such as local geography and weather, costs, applicable codes, national electric industry standards, sound engineering judgment and experience. The ISO is required to seek FERC authorization to secure generating and transmission resources necessary to guarantee planning and operating reserve criteria no less stringent than the standards of the Western Systems Coordinating Council and North American Electric Reliability Council.

On the distribution side, the CPUC is required to adopt inspection, maintenance, repair and replacement standards for the IOUs' distribution systems. In short, we expect no degradation in system reliability as a result of this new structure.

Unbundling

The California electric industry restructuring law requires the IOUs to identify and separate individual rate components, such as charges for generation, transmission, distribution, public benefit programs and CTCs. Separation of the rate components will ensure that a customer who purchases electricity through direct access pays the same unbundled component charges, other than energy, that a bundled service customer pays. PG&E has developed a new billing format that will be ready for use on January 1, 1998, in anticipation of this new arrangement.

On May 6, 1997, the CPUC took yet another step toward ensuring that competitive energy suppliers are able to participate in the California market by authorizing them to provide their own consolidated billing, metering and other related services (known as "revenue cycle unbundling"). Beginning January 1, 1998, competing energy service providers will be allowed to present consolidated bills that reflect the full cost of providing service. Energy service companies will also be allowed to provide meters for their customers, other than the meters commonly provided by the utility distribution company. Although much remains to be done to ensure that the system continues to operate safely, it reflects the accelerated pace with which California has embraced a fully restructured energy industry.

PG&E supports revenue cycle unbundling and is currently preparing for the time when all energy services are competitive. Because we believe our customers should have full retail choice, we are working with all of the affected parties to ensure that the transition occurs smoothly and safely and that we are ready to compete.

Public Power

Under the California electric industry restructuring law, local (state and municipal) publicly owned electric utilities may participate in the competitive marketplace. To do so, however, the publicly owned electric utilities must comply with rules similar to those applicable to the IOUs. A publicly owned utility may recover transition costs if it commits control of its transmission facilities to the ISO. A publicly owned utility may offer to sell its generation outside its service territory if it allows others to sell generation inside its territory. The California law opened the door to competition for the local publicly owned electric utilities on the condition that a level playing field for competition between local publicly owned and

privately held electric utilities was created. PG&E endorsed the approach adopted by the California Legislature.

Tax Code Changes

The electric industry restructuring changes being made by the states may require some changes be made to the federal tax code since existing tax law contains a number of tax provisions where a specific treatment of utilities is linked to, or mandated by virtue of cost of service or rate regulation. More utility business will be based on the competitive marketplace or incentive ratemaking principles, thus requiring corresponding tax changes. As an example, the ability to claim accelerated depreciation is dependent on regulators requiring a "normalized" method of accounting. We believe the tax law references to regulation need to be reviewed as electric industry restructuring moves forward.

Tax issues will also arise as new service providers enter what was a traditionally regulated market. Many of these issues relate to the ability of the federal, state, and local tax law to promote fairness for all participants in a competitive, deregulated marketplace. A part of the restructuring process should provide that all providers of electricity (i.e., utilities, power marketers, power brokers, co-ops, municipalities, etc.) be subject to the same or similar federal, state and local tax obligations. In addition, under existing law, some service providers are subject to divergent tax treatment (i.e., some electric generation facilities currently have different depreciation lives depending on whether the owner is a regulated public utility). As the debate continues, creation of a "level playing field" should be of paramount importance.

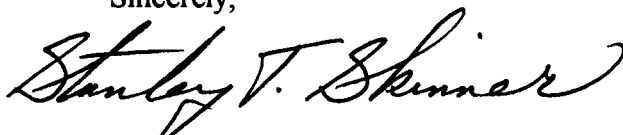
Conclusion

Many policy decisions are still evolving in the electric utility industry here in California, and we hope to be able to provide additional information on details of the California plan and PG&E's position, as the debate moves forward.

PG&E has served the citizens of northern and central California for more than 140 years. We are very excited about the challenges and opportunities the new paradigm presents. We look forward to serving the citizens of California and of the other states for many, many years to come.

We hope this information is helpful as you and your colleagues on the Commerce Committee review these issues. We want to reiterate our thanks for the early opportunity to discuss PG&E's view on electric industry restructuring at the federal level. We look forward to working with you as this debate continues.

Sincerely,



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